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DEPT PASS USTR FOR KATE DUCKWORTH  
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SENSITIVE  
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SUBJECT: BRAZIL: TREASURY DAS O'NEILL MEETS WITH GOB AND MDBs ON  
INFRASTRUCTURE AND OTHER ISSUES

SENSITIVE BUT UNCLASSIFIED - PROTECT ACCORDINGLY

¶1. (SBU) Summary: Treasury Deputy Assistant Secretary Brian O'Neill had economic meetings in Brasilia on December 12-13, 2007 with officials from the Brazilian Central Bank, Ministry of Finance, Ministry of Planning, as well as the World Bank and the Inter-American Development Bank. The meetings focused on the recent abolishment by the Brazilian Senate of the 10-year-old "Contribuicao Provisoria sobre a Movimentacao ou Transmissao de Valores e de Creditos e Direitos de Natureza Financeira" (CPMF - a tax on financial transactions); sovereign wealth funds; and continuing development and infrastructure challenges faced by the country. DAS O'Neill's visit was in conjunction with the Economic Partnership Dialogue reported septel. End Summary.

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Central Bank  
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¶2. (SBU) DAS O'Neill, accompanied by Treasury Attache Bill Block and Brasilia Econoff, met with officials of the Central Bank to discuss general economic trends in the country, the demise of the CPMF, and whether or not Brazil would be implementing sovereign wealth funds. The Central Bank interlocutors (Marcio Barreira de Ayrosa Moreira, Head of the International Reserves Operations Department; Ariosto Revoredo de Carvalho, Deputy Head of the Department; Daniela Silva Pires, Chief of Division of the External Debt and International Relations Department; and Luiz Sampaio Malan, Advisor to the latter Department) expressed optimism about future growth and development of Brazil's economy, including Brazil's emerging investment sector. They did not think the CPMF's expiration would have much impact on or hinder Brazil's growth, and also did not feel that sovereign wealth funds were going to be a factor in the country's growth and development. Central Bank officials stated that they had no information about the possible establishment of a sovereign wealth fund other than what they have read and heard publicly. Few if any discussions have taken place between the Finance Ministry and Central Bank about key issues, such as initial financing or asset allocations, involved in establishing such a fund.

¶3. (SBU) Separately, Central Bank officials stated that they believe long-term currency diversification of Central Bank foreign reserves made financial sense. Although the U.S. dollar will continue to play a dominant role in foreign reserve assets, its share is likely to decline in the future. Central Bank officials also stated that they are watching developments in the U.S. sub-prime market very closely. While sub-prime developments have increased risks to Brazil's economy, Brazil's base case outlook for 2008 remains that of continued strong growth and a rising, though well-contained, rate

of inflation.

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Brazilian Treasury Expresses Optimism . . .  
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14. (SBU) O'Neill then met with Luiz Eduardo Melin, now Secretary of International Relations of the Ministry of Fazenda (Brazil's Treasury equivalent). Melin downplayed any potential impact of the CPMF vote, saying that the fiscal accounts would remain strong and investment growth should increase in 2008. Melin cited two factors that would help to offset foregone CPMF revenue: (1) higher-than-expected revenue-to-GDP elasticity that is expected to continue in 2008 (and which will help to boost federal revenues), and (2) a modest reduction in the rate of health care spending. That said, he said the CPMF not being renewed would mean cuts in the areas of social benefits and that the GOB would be unable to develop as quickly as desired in such areas as public health and education. "Approximately half of what we lose with the CPMF will be regained," Melin said, and indicated that eventually he thinks the GOB will end up in precisely the same position as before, primarily due to what he characterized as the enormous relatively recent increase in private investments. Melin stated that the Senate's rejection of the CPMF renewal was politically motivated, and that the opposition of some senators was motivated by a desire "to score a political point against President Lula."

15. (SBU) DAS O'Neill indicated to Melin that Treasury would like to be helpful with regard to infrastructure assistance. As O'Neill pointed out, Treasury's view is that in Brazil, the challenges are more micro rather than macro; that is to say, identifying the projects and securing the financing are less problematic than the ongoing execution, logistics, and regulatory impediments. Once those challenges are overcome, projects should successfully progress

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from conception to implementation. Melin offered that Brazil "has had a hard time dealing with the fact that you can't monkey around and mismanage public finance," characterizing this as not just a federal government problem but a state government issue over the past 20 years. Nevertheless, he said that both institutionally and culturally Brazil is getting back on track to support the idea of growth, with much better expectations for the next year and beyond. Melin stated that Brazil has lost a substantial amount of its technical capacity to implement large infrastructure projects since the 1990's, and that it has taken longer than expected to rebuild this capacity. However, he believes Brazil's ministries are now well-positioned to launch projects on a much more accelerated time frame, and that a substantial increase in infrastructure investment will begin to be seen starting in 2008.

16. (SBU) Melin said Brazil will host workshops at the upcoming 2008 meeting of the G-20 on 1) competition and financial markets (the OECD will attend and will possibly be a presenter); 2) climate change from the perspective of finance ministers and central banks, which he characterized as a planned "very focused" workshop in London; and 3) the role of fiscal space in promoting growth and development, a workshop at which he expects some countries will share experiences. Melin said Brazil will talk about their experience leaving infrastructure by the wayside for too long; success and "not-so-success" stories will be presented as well, although he thought the meeting would "not be so best-practices oriented as the OECD." Regarding the Tropical Forest Conservation Act debt swap initiative (TFCA), Treasury officials stated that Treasury expects to complete its internal review of Brazil's TFCA request soon, and that a letter addressed to Finance Minister Mantega indicating approval was likely within the next 30 days.

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. . . But the World Bank is Less Optimistic  
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17. (SBU) DAS O'Neill, Treasury Attache Block and Econoff also met with John Briscoe, Country Director for the World Bank in Brasilia, who provided a pessimistic view of the current state and future of infrastructure development in Brazil. Briscoe said virtually no

planning pipeline exists in Brazil, and that "capacity planning and process at the government level has almost disappeared." He stated that efforts by outsiders to accelerate infrastructure investment in Brazil by "fixing Brazil's government" will never work. Instead, he recommended working more selectively and closely with state governments who are, in his view, more capable and dedicated to implementation of infrastructure projects.

18. (SBU) Briscoe said Minister Dilma Rousseff (chief of staff to President Lula in the Casa Civil), in a recent meeting with the head of the World Bank's International Finance Corporation (IFC), flatly stated that she "no longer believes in PPPs" (public-private partnerships). In Briscoe's view, this lack of confidence from the top leadership, combined with tensions among ministries (for example, Finance and Transportation), makes federal projects very difficult to implement. Briscoe used the example of the Rio Madeira hydroelectric project, saying it is needed and would benefit Bolivia as well as Brazil, but bureaucratic and regulatory challenges have drastically delayed the project's implementation. Due to difficulties working at the federal level, the World Bank in Brazil works primarily with state-level partners with the hope of eventually working up to success at the federal level. Separately, Briscoe asked that the U.S. Treasury do what it could to limit USAID funding for certain, in his view, allegedly "not well-intentioned" NGO groups (not specifically mentioned by name) in the Amazon region. He stated that the World Bank has attempted to work constructively with NGOs in achieving developmental and environmental goals in that region and had worked effectively with many.

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IDB Receptive Regarding Infrastructure Cooperation  
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19. (SBU) Jose Luis Lupo, head of the IDB Brazil mission, noted his office is developing the Brazil country strategy paper and, after talking to Brazilian business and government sources, he predicts that Brazil is not going to take advantage of its positive macro environment to put tax reform, labor reform or other reforms in place. IDB believes Brazilian reforms will be indefinitely postponed for political reasons. Lupo also felt the PAC was problematic - Brazil has money, but not the expertise to develop

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programs and projects. IDB can offer technical assistance loans to prepare programs. IDB could help Brazil invest in projects, particularly, given its regional expertise, in cross-border PAC initiatives. Lupo noted that IDB enjoys an almost zero percent default rate on its loans, while BNDES has a high default rate and is constrained in cross-border project participation (since BNDES can only fund Brazilian parts). While the high-speed Rio/Sao Paulo rail project is the only PAC initiative IDB is currently working on with the government, IDB has requested Brazil provide its top five priority PAC projects where the country would like IDB help (no response yet, per Lupo). Lupo noted that energy, followed by transportation, were the top regional infrastructure priorities.

110. (SBU) Lupo noted Dilma Rousseff said in a recent meeting that Brazil would proceed with the Madeira project, but without planned IDB participation. The government was prepared to handle local NGO opposition, but felt IDB participation would draw international NGOs the government did not want to face. In that same meeting with IDB and BNDES, when BNDES reported a planned 2008 allocation of 4.5 bn reais for public-private partnerships, Dilma reportedly said the government now believes PPPs do not work and would not do any more; future projects would be either all-private, all-public or concessions. Lupo noted that previously, Brazil was the only IDB country that would not accept funding for feasibility studies, based on resistance to outsiders' advice, but the government seemed more receptive in the current environment to working with World Bank and IDB, provided the cooperation was not too public. He attributed this development to government realization that PAC was only going to succeed if the private sector were willing to participate and the private sector would only participate if the bottlenecks and redtape were eliminated. Like World Bank, IDB strategy has been to work at

the state level with hopes to build more productive cooperation at the federal level over time.

¶11. (SBU) COMMENT: DAS O'Neill's visit was a productive opportunity to advance development of an infrastructure initiative. The similarity in substance, if not tone, of the IDB and World Bank meetings was striking. Lack of technical expertise in project planning and implementation in the sectoral ministries clearly needs to be addressed. Addressing over-bureaucratization and unpredictability at the federal level, among other factors, will also be important in attracting private sector foreign investment in infrastructure. END COMMENT.

This message includes input and clearance from Treasury Attache based in Sao Paulo.

SOBEL